

- ** __ ** million of Account 6622 for directory production expenses.

21. After these corrections, the wholesale discount for services other than Operator Services is reduced from 19.2% to 10.04%..

Figure 2

| Staff Methodology | | | | | |
|--|------------------------|---------------------------------------|--------------------------|------------|--------------|
| Calculation Detail by Account of Development of Wholesale Discount | | | | | |
| 1996 ARMIS Data (\$000) | | | | | |
| Operator Services | | | | | |
| Costs | | | | | |
| | Accounts | Account Name | Total Missouri Regulated | % Avoided | SWBT Avoided |
| Direct Costs | 6611 | Product Management | \$ 7,206 | 50.00% | \$ 3,603 |
| | 6612 | Sales | \$ 22,214 | 90.00% | \$ 19,993 |
| | 6613 | Product Advertising | \$ 11,022 | 90.00% | \$ 9,920 |
| | 6621 | Call Completion Services | \$ 11,181 | 0.00% | \$ - |
| | 6622 | Number Services | \$ 34,145 | 0.00% | \$ - |
| | 6623 | Customer Services | \$ 95,206 | 90.00% | \$ 85,685 |
| Indirect Costs | 5301 | Uncollectible Revenue | \$ 16,669 | 11.36% | \$ 1,893 |
| | 6112 - 6116 | | \$ 981 | 0.00% | \$ - |
| | 6121 - 6124 | | \$ (31,437) | 11.36% | \$ (3,596) |
| | 6211 - 6232 | Central Office | \$ 78,213 | 0.00% | \$ - |
| | 6311 - 6362 | Information Origination / Termination | \$ 24,436 | 0.00% | \$ - |
| | 6411 - 6441 | Cable & Wire Facilities | \$ 123,287 | 0.00% | \$ - |
| | 6511 - 6565 | Plant Non-Specific Operations | \$ 510,721 | 0.00% | \$ - |
| | 6711 - 6728 | Corporate Operations | \$ 145,639 | 11.36% | \$ 16,536 |
| | Total | | \$ 1,049,483 | | \$ 134,034 |
| Revenues | | | | | |
| | | | Percent Included | | |
| | Local Service | \$ 807,299 | 100.00% | \$ 807,299 | |
| | Toll Network Service | \$ 156,649 | 100.00% | \$ 156,649 | |
| | Network Access Service | \$ 444,248 | 0.00% | \$ - | |
| | Miscellaneous | \$ 172,704 | 0.00% | \$ - | |
| | Total | \$ 1,580,900 | | \$ 963,948 | |
| Resale Percentage Discount on Revenue | | | | | 13.90% |

22. Besides the mistreatment of operator services expenses, the discount calculations contain other errors:

- First, substantial portions of the costs charged to key accounts - *customer services, number services, sales and product management expenses* - are caused by activities associated with services which are *not* for resale. These costs are not included in the prices of services to be resold and are not avoided when those services are resold. This information was provided to Staff during the review process.
- Second, significant costs in these accounts are for administrative activities performed today which will continue to be performed in the future and will become shared costs of retail and wholesale operations. These activities are not avoidable. This information was also provided to Staff during the review.
- Third, the Company expects to incur *new* costs, particularly in the areas of product management and product advertising, as the wholesale business develops. The Company should be allowed to recover these costs in wholesale rates.

23. SWBT provided the staff a detailed analysis of the costs in accounts 6611 - 6613 and 6623 which are caused by activities either for *non-resale services* (including services already offered as wholesale) or for *administrative activities which will continue in the future in support of retail and wholesale operations*.¹ This information was not used in the discount calculation. Instead, the Commission used the arbitrary percentages from the FCC Order rules, now vacated. There is no evidence supporting these percentages. The results of SWBT's account analyses are summarized in Figure 3.

¹ The analysis of activity costs which are not avoidable is shown in Schedule 2. It was provided to the staff on *reference*.

Figure 3

**Activity Cost Analysis
1996 ARMIS Data and SWBT Job Function Cost Detail (\$000)**

| Accounts | Account Name | Total Missouri Regulated | Not for Resale / Already Wholesale | General Administrative | Subtotal - Not Avoided | Percent of Account |
|----------|---------------------|-----------------------------|---------------------------------------|---------------------------|---------------------------|-----------------------|
| 6611 | Product Management | \$ 7,206 | \$ 1,797 | \$ 2,474 | \$ 4,271 | 59% |
| 6612 | Sales | \$ 21,737 | \$ 3,336 | \$ 247 | \$ 3,584 | 16% |
| 6613 | Product Advertising | \$ 11,022 | \$ - | \$ 69 | \$ 69 | 1% |
| 6623 | Customer Services | \$ 93,546 | \$ 17,979 | \$ 5,899 | \$ 23,878 | 26% |

24. Staff discusses its rationale for advertising on page 181 of its report. Their reasoning for setting the advertising account at 90% avoided centers around a misunderstanding of SWBT's position on advertising. Staff states that "there is no compelling rational reason SWBT would assist a competitor by jointly advertising that competitor's product in direct competition with its own." Staff's misunderstanding here is that if SWBT were only a wholesaler, it would not be doing the advertising in direct competition with the resellers, because the resellers would be SWBT's only customers. However, SWBT would be doing joint advertising, much like it does with its agency accounts now. As a matter of fact, SBC is doing advertising now at wholesale trade shows and that advertising is entirely aimed at the reseller.

25. In addition, the remainder of accounts 6611 and 6613 contain expenses SWBT will continue to incur in a wholesale environment. Figure 1 shows that adjusting the calculations for these existing costs which will not be avoided in the future lowers the discount rate for local and toll services from 19.2% to 10.04%.

26. SWBT also has shown that it will incur new product management and product advertising expenses to support a wholesale line of business.² It is inappropriate to treat any of these expenses as avoidable.

² See *Smith Direct* pp. 7-8.

27. SWBT does not dispute that access services will not be offered for resale, but that the costs of access should not be included in the numerator of the aggregate discount. During its discussions with the Staff, SWBT admitted that it was difficult to identify access expenses within each account, but it had identified access expenses associated with the major accounts to prove to Staff that amount avoided was less than the 90-100% dictated by the FCC Order. This information was provided to Staff.

28. The Operator Services discount of 13.9% proposed by the staff similarly overstates the avoided costs in accounts 6611 - 6613 and 6623. SWBT proposes using the Service by Service Avoided Cost Analysis discount for operator services, which is 3.15%. The Service by Service study clearly shows that Operator Services does not require the level of sales and customer services expenses of other services.³ A 13.9% discount on operator services would, therefore, be much too high.

29. The wholesale discounts adopted by the Commission of 19.2% for local and toll services and 13.9% for Operator Services are much too high. Many of the costs presumed to be avoided are for services not subject to resale or for existing wholesale services. Moreover, the Commission has not recognized the costs the company will incur to provide wholesale services, and it has assumed no call completion or number services expenses will be incurred in spite of the fact the Company has signed agreements for these services.

30. Finally, the Commission's proposed discount on Operator Services of 13.9% is much too high. SWBT's Service by Service Resale Avoided Cost Analysis shows that only a small percentage of service costs are avoidable for this specific service. Basing its discount on an aggregate avoided cost to revenue ratio substantially overstates the required discount.

³ This is a good indication of the value of a service-specific avoided cost analysis and service-by-service discounts.

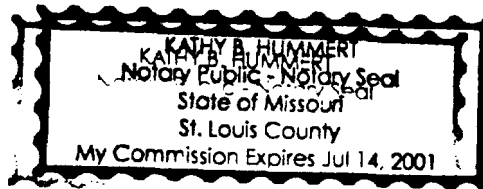
31. For these reasons, SWBT recommends that the Commission and staff reconsider the staff's proposed discounts to reflect a proper accounting for the avoided costs of resale.

Barbara A. Smith
Barbara A. Smith

STATE OF MISSOURI)
) SS
CITY OF ST. LOUIS)

Subscribed and sworn to before me this 20th day of August 1997.

Kathy B. Hummert
Notary Public



MISSOURI RESALE AVOIDED COST ANALYSIS OVERVIEW/METHODOLOGY

PURPOSE

For a company serving as a wholesaler to resellers, the avoided costs of resale of a given service are defined as:

- (1) the costs of providing the given service at retail which cease to be incurred due to the wholesaling of that service to a reseller in lieu of providing the service at retail directly to end-users

minus

- (2) the costs of wholesaling the given service to resellers.

This analysis identifies the shift in costs comparing a before and after resale environment. With resale, some functions to service SWBT end users will be avoided, but in some instances offsetting functions will be incurred to service the reseller market

Service order processing would be affected in that a service representative will avoid processing a service order when a new end user customer purchases service from a reseller. Likewise, if an existing end user customer purchases a portion of their service at retail via SWBT, and purchases other portions of their service from a reseller, a portion of service order costs are also avoided. However, when the reseller places an order with the Provider Resource Center, a service representative in the PRC will process the order. This cost is included in the support costs.

Billing inquiry would be affected in that a service representative will avoid handling of a billing inquiry when the end user customer purchases service from a reseller. When the end user with resold service does have a billing inquiry, they will direct that inquiry to the reseller for resolution. In some cases, the reseller may have questions regarding the bill issued to them from SWBT. In these cases, the Provider Resource Center will respond to the reseller's billing inquiry. This cost is included in the support costs.

Collection inquiry would be affected in that a service representative or revenue management representative will avoid handling of a collection inquiry when the end user customer purchases service from a reseller, to the extent that customers who don't pay their bill in a timely manner purchase services through resale. Any collection efforts of SWBT to collect from end user customers of resellers would be handled on a contract basis, the costs of which are outside the boundaries of this analysis.

Finance operations and information systems activities will not be avoided in a resale environment. And in fact, additional finance and information systems activities will be performed to meet the needs of the resale market. These activities and associated costs are identified in a separate study.

Some marketing activities will be avoided, while others will not be. Sales efforts of the Premise Sales organization, such as Account Executives, Account Managers, Communication Consultants, etc., will avoid sales efforts when end user customers purchase service via a reseller. However, there are Account Teams established specifically to maintain contacts and meet the needs of resellers. This cost is included in the support costs.

Traditional product management activities will not be avoided. Product management efforts will still be expended to develop and market products that meet the needs of retail customers. Without this development and marketing effort, product lines would stagnate for both retail as well as wholesale customers. There is a separate product management group established to represent the needs of wholesale customers. This cost is included in the support costs.

Incentives paid to service representatives and sales force personnel will be reduced to the extent that sales to end user customers are reduced. There are no incentive costs anticipated in the Provider Resource Center.

Rendering the customer a bill functions will be impacted by resale. To the extent that the entire customer account goes to a reseller, bill processing, paper, envelopes, and postage will be avoided. However, there will be some bill processing and electronic transfer costs to provide the reseller with a bill.

Uncollectibles will be avoided to the extent that end user customers who do not pay their bill purchase service via a reseller. It is anticipated that resellers will cause uncollectibles to the extent that Interexchange carriers do.

Network installation, maintenance and repair functions performed will remain unchanged, as the same functions will be performed for both retail and reseller end user customers. Training of network personnel will take place to familiarize employees with their responsibilities in terms of providing service to resale end user customers. This cost is reflected in a separate study.

DESCRIPTION

The avoided costs identified in this study include service order activity costs, incentive awards, billing inquiry costs, collection inquiry costs, sales force wages, customer billing costs, collection processing costs, and uncollectibles for specific product groupings. The product groupings for Residence are Lines, Optional Exchange Services, Call Management Services, Caller ID Services, Other Vertical Services, Remote Call Forwarding, Wide Area Telephone Service (WATS), Toll Optional Calling Plans, and Message Telephone Service (MTS). The product groupings for Business are Lines, Optional Exchange Services, Call Management Services, Caller ID Services, Other Vertical Services, Remote Call Forwarding, Wide Area Telephone Service (WATS), Toll Optional Calling Plans, Message Telephone Service (MTS), Plexar 1, Digital Link Services, Plexar 2, Trunks, ISDN, and Analog Private Line (APL).

These costs are developed as a ratio of the associated product grouping revenues. Also identified is the cost of providing support services to resellers. The total avoided cost is the difference in the costs saved and the costs incurred to service the resellers.

METHODOLOGY

Residence Service Center, Business Service Center and Premise Sales

Avoided costs due to resale in the Residence Service Center (RSC), Business Service Center (BSC) and Premise Sales include the order center, incentive awards, billing inquiry and collection inquiry time. Order, billing inquiry and collection inquiry time were multiplied by the hourly labor rate, then by the total number of orders and inquiries, respectively. The total cost of orders and inquiries was allocated to the appropriate product groupings based on ratios of USOCs on service orders. This cost plus the cost of incentives for the product groupings was divided by the revenue generated by the products to determine the avoided cost percentage.

Premise Sales - Sales Force Wages

Additional avoided Premise Sales costs are related to the wages of the sales force. The total of the wages for the sales force were allocated to the product groupings based on percentages of sales force time spent on the product groupings. This cost was divided by the revenue generated by the products to determine the avoided cost percentage.

Billing

Avoided billing costs were calculated separately for Residence, Business, and Operator Services. A distinction was made for those services causing a fundamental bill and MTS services. The current cost of rendering a bill to a SWBT end user was calculated less the costs to deliver billing data to the reseller. These calculations are based on an assumption that the entire customer account is lost to the reseller, and therefore, all postage and related expenses are avoided. Should the reseller take only a portion of a customer account, the discount is overstated since SWBT would continue to incur postage, envelope and other bill processing costs.

Collection Processing

The avoided collection processing costs are calculated by adding the total cost of final account processing, reminder notices, verification referrals, and denial notices, divided by the recurring revenues. This calculation is done separately for Residence and Business.

Uncollectibles

Avoided uncollectible costs are calculated as the difference between Residence and Business uncollectible rates and the projected reseller uncollectible rate. A five-year average of SWBT Residence and Business uncollectibles was used. Because no reseller uncollectible data is available at this time, the five-year average of booked interexchange carrier uncollectibles was used as a surrogate for the reseller uncollectible rate.

Support Costs

Support Costs for the Resale Account Team, Local Service Provider Service Center and Product Management organizations were identified. Wages for the account team, service representative, and product managers were calculated, and adjusted where appropriate to reflect the portion of LSP costs due to resellers only. Support costs for resellers were divided by the projected reseller revenues to determine the percentage of costs incurred. These calculations represent a total Company view since the support organizations service all states.

**MISSOURI RESALE AVOIDED COST ANALYSIS
RESULTS**

| | <u>COST SAVINGS</u> <u>(% OF REVENUE)</u> |
|-----------------------------|--|
| RESIDENCE | |
| LINES | 16.28% |
| OPTIONAL EXCHANGE SERVICES | 7.35% |
| CALL MANAGEMENT SVCS | 11.60% |
| CALLER ID SERVICES | 16.53% |
| OTHER VERTICAL SERVICES | 29.90% |
| REMOTE CALL FORWARDING | 21.11% |
| WIDE AREA TELEPHONE SVC. | 15.02% |
| TOLL OPTIONAL CALLING PLANS | 10.46% |
| MTS | 7.98% |
| OPERATOR SERVICES | |
| OPERATOR SERVICES | 3.15% |
| BUSINESS | |
| LINES | 7.05% |
| OPTIONAL EXCHANGE SERVICE | 6.07% |
| CALL MANAGEMENT SVCS | 8.65% |
| CALLER ID SERVICES | 9.15% |
| OTHER VERTICAL SERVICES | 11.98% |
| REMOTE CALL FORWARDING | 9.27% |
| WIDE AREA TELEPHONE SVC. | 8.10% |
| TOLL OPTIONAL CALLING PLANS | 14.09% |
| MTS | 4.11% |
| PLEXAR 1 | 10.13% |
| DIGITAL LINK SERVICES | 23.62% |
| PLEXAR 2 | 24.64% |
| TRUNKS | 8.56% |
| ISDN | 14.80% |
| ANALOG PRIVATE LINE | 6.90% |

MISSOURI - ACCOUNT 6612 - SALES

| Acct | Sub | JFC | Description | Code | Total | Non Reg % | NonReg | Reg | Total | Percent |
|------|-----|------|--|------|-------|-----------|--------|-----|-------|---------|
| 6612 | 1 | 2240 | Nonsegment support | A | | | | | | |
| 6612 | 1 | 2220 | Selling - Public | N | | | | | | |
| 6612 | 1 | 2221 | Selling - Public (Communications Consulta | N | | | | | | |
| 6612 | 1 | 2231 | Selling - Interexchange Carriers | W | | | | | | |
| 6612 | 1 | 2200 | Selling - Business | Y | | | | | | |
| 6612 | 1 | 2201 | Servicing and Implementation (Communica | Y | | | | | | |
| 6612 | 1 | 2202 | Selling - Business - (DM/DR) or (PPC) | Y | | | | | | |
| 6612 | 1 | 2210 | Selling - Residence - (DM/DR) or (PPC) | Y | | | | | | |
| 6612 | 1 | 2206 | General Administration/Support/Supervisio | Y | | | | | | |
| 6612 | 1 | 2260 | Servicing and Implementation - Authorized | Y | | | | | | |
| 6612 | 1 | 2266 | Monitoring and Training of Authorized Agen | Y | | | | | | |
| 6612 | 91H | 8149 | Comm Paid Affil Agents | Y | | | | | | |
| 6612 | 91J | 814A | Comm Paid Non Affil Agents | Y | | | | | | |
| 6612 | 924 | 813N | Of Comm Pd - IMTS | Y | | | | | | |
| 6612 | 925 | 813P | Of Comm Pd - other | Y | | | | | | |
| 6612 | 93 | 5620 | Sales Employee Sales Referral Program | Y | | | | | | |

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A=ADMINISTRATIVE
N=NOT FOR RESALE
W=ALREADY WHOLESALE SERVICE
Y=SERVICE AVAILABLE FOR RESALE

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MISSOURI - ACCOUNT 6613 - ADVERTISING

| Acct | Sub | JFC | Description | Code | Total | Non Reg % | NonReg | Reg | Total | Percent |
|------|-----|-----|--|------|-------|-----------|--------|-----|-------|---------|
| 6613 | 1 | | 03TA Gen Admin/Support - Product Advertising | A | | | | | | |
| 6613 | 1 | | 0301 Product Advertising | Y | | | | | | |

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MISSOURI - ACCOUNT 6621 CALL COMPLETION

| Acct | Sub | JFC | Description | Code | Total | Non Reg % | NonReg | Reg | Total | Percent |
|------|-----|------|---|------|-------|-----------|--------|-----|-------|---------|
| 6621 | 941 | 56M3 | SNFA | N | | | | | | |
| 6621 | 945 | 56M0 | Tr Bel Reg Jrd Whn Mlt Co-Ccs | N | | | | | | |
| 6621 | 946 | 56M1 | Tr Bel Reg Jrd Whn Mlt Co-Acqs | N | | | | | | |
| 6621 | 947 | 56M2 | Tr Bel Reg Jrd Whn Mlt Co-MIS | N | | | | | | |
| | | | | | | | | | | |
| 6621 | 12 | 2170 | Teletypewriter-Operations | Y | | | | | | |
| 6621 | 131 | 2146 | Intercept-Operator Reference Source Mtc | Y | | | | | | |
| 6621 | 132 | 2163 | Message Services Data Base Administrati | Y | | | | | | |
| 6621 | 141 | 2106 | Intralata Toll and Assistance-Operators | Y | | | | | | |
| 6621 | 141 | 2107 | Intralata Toll and Assistance-Local Suppor | Y | | | | | | |
| 6621 | 141 | 2108 | Intralata Toll and Asst Clerical | Y | | | | | | |
| 6621 | 141 | 2904 | Force/Facilities-Toll and Assistance Intrala | Y | | | | | | |
| 6621 | 141 | 2934 | Facilities Toll and Assistance Intralata Traf | Y | | | | | | |
| 6621 | 141 | 21TD | Toll & Asst Intralata Traffic/Hotel Billing Inf | Y | | | | | | |
| 6621 | 143 | 2140 | Intercept-Operators | Y | | | | | | |
| 6621 | 143 | 2141 | Intercept-Local Support | y | | | | | | |
| 6621 | 131 | 2147 | Intercept-Operator Reference Source Mtc | Y | | | | | | |
| 6621 | 143 | 2903 | Force/Facilities-Mechanized Intercet Syste | y | | | | | | |
| 6621 | 143 | 2933 | Facilities-Mech Interc-Sy | Y | | | | | | |
| 6621 | 144 | 2123 | Hotel Billing Information System (HOBIS)- | Y | | | | | | |
| 6621 | 144 | 2124 | Hotel Billing Information System (HOBIS)- | Y | | | | | | |
| 6621 | 144 | 2128 | Hotel Blg Info Sys Clerical | Y | | | | | | |
| 6621 | 943 | 2140 | Intercept-Operators | Y | | | | | | |
| 6621 | 92 | 2170 | Teletypewriter-Operations | Y | | | | | | |
| 6621 | 931 | 2146 | Intercept-Operator Reference Source Mtc | Y | | | | | | |
| 6621 | 931 | 2147 | Intercept-Operator Reference Source Mtc | Y | | | | | | |
| 6621 | 932 | 2163 | Message Services Data Base Administrati | Y | | | | | | |
| 6621 | 941 | 2106 | Intralata Toll and Assistance-Operators | Y | | | | | | |
| 6621 | 941 | 2107 | Intralata Toll and Assistance-Local Suppor | Y | | | | | | |
| 6621 | 941 | 2108 | Intralata Toll and Asst Clerical | Y | | | | | | |
| 6621 | 941 | 2904 | Force/Facilities-Toll and Assistance Intrala | Y | | | | | | |

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MISSOURI - Acount 6621 CALL COMPLETION

| Acct | Sub | JFC | Description | Code | Total | Non Reg % | NonReg | Reg | Total | Percent |
|------|-----|------|---|------|-------|-----------|--------|-----|-------|---------|
| 6621 | 943 | 2933 | Facilities-Mech Interc-Sy | Y | | | | | | |
| 6621 | 941 | 2934 | Facilities Toll and Assistance Intralata Traf | Y | | | | | | |
| 6621 | 941 | 21TD | Toll & Asst Intralata Traffic/Hotel Billing Inf | Y | | | | | | |

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MISSOURI - ACCOUNT 6622 - NUMBER SERVICES

| Acct | Sub | JFC | Description | Code | Total | Non Reg % | NonReg | Reg | Total | Percent |
|------|------|------|--|------|-------|-----------|--------|-----|-------|---------|
| 6622 | 111 | 219A | General Admin-DA Rep Mfg | A | | | | | | |
| 6622 | 112 | 21TA | Operator Services Administration/Support | A | | | | | | |
| 6622 | 112 | 21TE | Supt Srvs Supt Oper Srvs | A | | | | | | |
| 6622 | 911 | 219A | General Admin-DA Rep Mfg | A | | | | | | |
| 6622 | 912 | 21TA | Operator Services Administration/Support | A | | | | | | |
| 6622 | 912 | 21TE | Supt Srvs Supt Oper Srvs | A | | | | | | |
| 6622 | 121 | 92B1 | Cleared Sal & Wage & Other Exp | N | | | | | | |
| 6622 | 1211 | 92B1 | Cleared Sal & Wage & Other Exp | N | | | | | | |
| 6622 | 92 | 92B2 | Number Service Other Ex-Dir White Page | Y | | | | | | |
| 6622 | 921 | 92B2 | Number Service Other Ex-Dir White Page | Y | | | | | | |
| 6622 | 922 | 92B3 | Number Service Ol Ex-White Pages Bld F | Y | | | | | | |
| 6622 | 111 | 2134 | Directline/Custom Data Base Update and | Y | | | | | | |
| 6622 | 111 | 2136 | Directory Assistance Operator Reference | Y | | | | | | |
| 6622 | 111 | 2137 | Dir Asst Oper Ref Supvn & Ast | Y | | | | | | |
| 6622 | 111 | 2138 | DLC Databs Updt & Mtce Clrcd | Y | | | | | | |
| 6622 | 111 | 2190 | Directory Assistance Addenda and Reprint | Y | | | | | | |
| 6622 | 112 | 2130 | Directory Assistance-Operators | Y | | | | | | |
| 6622 | 112 | 2131 | Directory Assistance-Local Support | Y | | | | | | |
| 6622 | 112 | 2132 | Operator Service Cler Da | Y | | | | | | |
| 6622 | 112 | 2139 | DLC Databs Updt & Mtce Sup & Asst | Y | | | | | | |
| 6622 | 112 | 2901 | Force-Directory Assistance Systems | Y | | | | | | |
| 6622 | 112 | 2931 | Facilities-Directory Assistance-Systems | Y | | | | | | |
| 6622 | 112 | 213U | Job Trng-Da-Inwals | Y | | | | | | |
| 6622 | 121 | 2501 | White Pages Advertising | Y | | | | | | |
| 6622 | 122 | 92B5 | Number Service-Dir White PagesTele-Hel | Y | | | | | | |
| 6622 | 911 | 2134 | Directline/Custom Data Base Update and | Y | | | | | | |
| 6622 | 911 | 2136 | Directory Assistance Operator Reference | Y | | | | | | |

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MISSOURI - ACOUNT 6622 - NUMBER SERVICES

| Acct | Sub | JFC | Description | Code | Total | Non Reg % | NonReg | Reg | Total | Percent |
|------|-----|------|--|------|-------|-----------|--------|-----|-------|---------|
| 6622 | 911 | 2137 | Dir Asst Oper Ref Supvn & Asst | Y | | | | | | |
| 6622 | 911 | 2138 | DLC Databs Updt & Mtce Clrcd | Y | | | | | | |
| 6622 | 911 | 2190 | Directory Assistance Addenda and Reprint | Y | | | | | | |
| 6622 | 912 | 2130 | Directory Assistance-Operators | Y | | | | | | |
| 6622 | 912 | 2131 | Directory Assistance-Local Support | Y | | | | | | |
| 6622 | 912 | 2132 | Operator Service Cler Da | Y | | | | | | |
| 6622 | 912 | 2139 | DLC Databs Updt & Mtce Sup & Asst | Y | | | | | | |
| 6622 | 912 | 2901 | Force-Directory Assistance Systems | Y | | | | | | |
| 6622 | 912 | 2931 | Facilities-Directory Assistance-Systems | Y | | | | | | |
| 6622 | 924 | 92B7 | Number Service-Dir White Pages Tele-Hel | Y | | | | | | |

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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FCC MAIL ROOM

In the Matter of AT&T Communications)
of the Southwest, Inc.'s Petition for)
Arbitration pursuant to Section 252(b))
of the Telecommunications Act of 1996)
to Establish an Interconnection Agreement)
with Southwestern Bell Telephone Company)

Case No. TO-97-40

Petition of MCI Telecommunications)
Corporation and its Affiliates,)
Including MCImetro Access Transmission)
Services, Inc. for Arbitration and)
Mediation Under the Federal)
Telecommunications Act of 1996 of)
Unresolved Interconnection Issues)
with Southwestern Bell Telephone)
Company)

Case No. TO-97-67

AFFIDAVIT OF PAUL L. COOPER

I, Paul L. Cooper, of lawful age, being duly sworn, depose and state:

1. My name is Paul L. Cooper and I am Division Manager-Separations and Settlements for Southwestern Bell Telephone Company (SWBT). My business address is One Bell Center, 31-C-01, St. Louis, Missouri 63101. My qualifications, background and work history are included in my pre-filed direct testimony in the AT&T/MCI arbitrations, Missouri Public Service Commission Case Nos. TO-97-40 and TO-97-67.

2. **PURPOSE AND SUMMARY OF AFFIDAVIT.** The purpose of this affidavit is to contrast SWBT's actual historical book or embedded costs to the level of costs and rates ordered by the Missouri Public Service Commission (PSC) in its Final Arbitration Order¹ in

¹ Case Nos. TO-97-40 and TO-97-67; Final Arbitration Order issued July 31, 1997.

this proceeding. The information set forth in this affidavit demonstrates the impact on SWBT of the failure of the Missouri PSC to use or consider actual costs when setting prices related to local interconnection agreements.

The historical cost standard utilized by the PSC under the rate base/rate of return regulation for SWBT in Missouri has been the actual book costs as defined by FCC Rules, Part 32 and Part 36 procedures. This cost standard (a) determined total costs for facilities used to provide service, (b) determined the respective interstate (FCC) versus intrastate (Missouri PSC) cost responsibility for recovery in just and reasonable rates and (c) established support from toll and access rates to enable the maintenance of reasonably priced local exchange rates. In its Final Arbitration Order in this proceeding, the PSC adopted a new hypothetical forward-looking cost standard as the basis for establishing rates for unbundled network elements (UNEs). This standard results in the under recovery of SWBT's actual facility costs.

3. **DESCRIPTION OF SWBT'S NETWORK FACILITIES.** The SWBT telecommunications network is comprised of three basic building blocks which may be described as loop facilities, local switching facilities, and interoffice transport facilities. Loop facilities are the communications paths which connect a customer's residential or business location to the telephone company local switching office. Switching facilities are contained in the local switching office, which is the hub of the loop facilities for a geographical area known as a "wire center." The local switch connects one customer's loop facility to another loop facility, or a trunk to another local switch which completes a communications link. Transport facilities are of two types: a tandem switch is the switch which is used to connect local switching offices, and interoffice trunking facilities which

provide the communications paths between switches. Customers may use the SWBT telecommunications network for services which are further classified as local, intrastate intraLATA toll, and access to an interexchange carrier for interstate and intrastate interLATA long distance toll (access services).

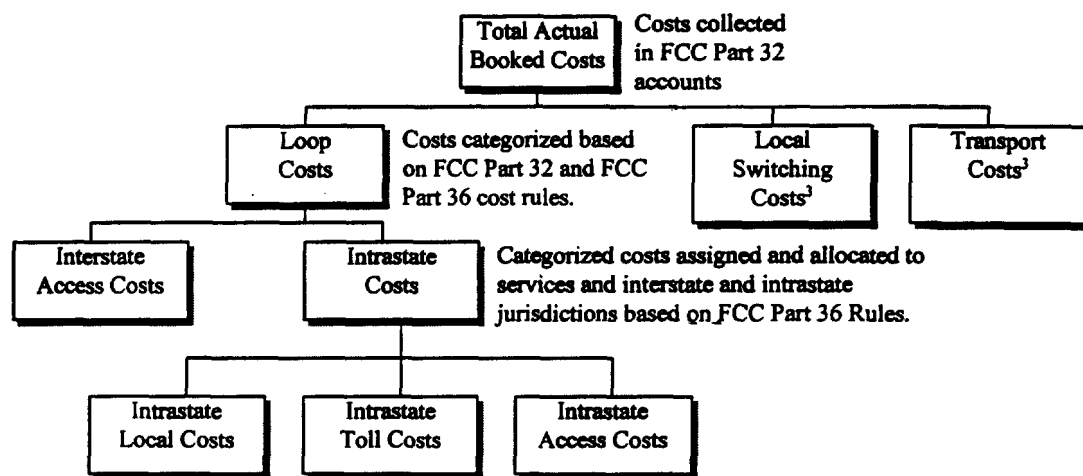
4. ACCOUNTING RULES USED TO DETERMINE THE COST OF NETWORK FACILITIES. The costs expended by SWBT to construct and maintain loop, local switching and transport facilities are recorded in accounting records prescribed by Part 32 of the FCC Rules and Regulations - Uniform System of Accounts (USOA). These recorded book costs are assigned to the particular facility category (loop, local switch and transport) in accordance with methodologies contained in FCC Rules and Regulations, Part 36, Separations Manual. These cost accounting rules (Part 32 and Part 36) have been in place for many years and have been mandated by the Federal (FCC) and used by the State jurisdictions, including Missouri.

These rules uniformly govern the following functions:

- Accounting for regulated costs.
- Classifying costs by network function (i.e., loop, local switching or transport).
- Assigning the total Part 32 accounted costs to either the FCC's jurisdiction or the State's jurisdiction (using Part 36 rules) in order to allow the regulators in each jurisdiction to know their share of the total costs for which they are responsible in order to establish just and reasonable rates to recover the costs.

SWBT is, and has been, required by the FCC and Missouri PSC to follow these FCC accounting rules, regulations and procedures.

5. **CURRENT FEDERAL AND STATE RATES THAT ARE BASED ON AND RECOVER THESE ACTUAL COSTS.** The actual costs which were assigned to the FCC and Missouri intrastate jurisdictions are further subdivided by Part 36 rules into intrastate local, intrastate intraLATA toll and interstate and intrastate access service costs² generally based on the amount of time they are used in providing local, toll and access service. The following figure depicts this process for loop costs:³



Both the FCC and the Missouri PSC, respectively, have established rates for local, toll and access services so that each service recovers some or all of its share of these actual costs as determined by Part 32 and Part 36 accounting procedures. Today's rates are founded on, and in the aggregate, recover the actual booked costs incurred by SWBT to provide service in Missouri.

² Local services costs comprise the local services purchased by customers including the monthly local service rate and any custom calling services such as Call Waiting, Call Forwarding, etc. Toll services are the costs for long distance toll service offered by SWBT. Interstate or intrastate access service costs are the costs of SWBT facilities used by Interexchange carriers to deliver their interLATA toll services.

³ The assignment process for the local switching and transport actual cost categories (not shown on the figure) is accomplished in a similar manner.

6. **USE BY FCC AND MISSOURI PSC OF THE PART 32 AND 36 PROCESS TO ESTABLISH SOCIAL POLICY RATE DISCOUNTS FOR LOCAL SERVICE.** The Part 36 costing rules employ cost methods established by the Joint Board⁴ and the FCC which ensure that the costs assigned to local service will result in low basic local rates for all customers in the state of Missouri in order to ensure that as many people as possible can be connected to the network (i.e., to provide Universal Service). This is accomplished through a number of cost and revenue transfers, often called support mechanisms, which are designed to keep the rates of local basic local service low by recovering a significant share of local exchange service costs from the rates for other services. For loop costs this FCC/State actual costing process works as follows:

a) As shown in Schedule 4-1, in my pre-filed testimony in Case Nos. TO-97-40 and TO-97-67, the costs to provide local exchange service for SWBT customers varies significantly throughout the state of Missouri. It is much more costly to install local exchange service (loop, local switching, and transport) in rural areas of Missouri with sparse populations than it is in densely populated urban areas. For example, the average actual local exchange cost (loop, local switching and transport) for SWBT customers in mostly low-volume rural areas of Missouri is \$121.26⁵ per line per month, while the cost in high-volume areas such as Kansas City and St. Louis is on the average \$32.10⁵ per line per month. In order to mask these cost differences, the Part 32 and Part 36 costing procedures

⁴ The Joint Board is a body comprised of FCC and State Commissioners which jointly decide on the nature of Part 36 rules. Both Commissions are involved in deciding how the Part 36 rules will be constructed because the jurisdictional cost assignments resulting from the application of Part 36 rules determine the share of the total Part 32 costs that the regulatory body in each jurisdiction (federal or state) must recover in rates.

⁵ This data is based upon a 1993 study of SWBT's actual costs.

average the local exchange service costs on a statewide basis for all of SWBT's Missouri customers. The statewide average local exchange service cost is \$39.95⁶ per line per month.

(b) If further steps were not taken, local customer rates would have to be at a level of \$39.95 per line per month to recover actual local exchange service costs. Consequently, in order to develop low local exchange rates, the FCC and Joint Board created costing rules in Part 36 which allocate a significant share of the statewide average loop costs to be recovered from SWBT's rates for interstate access, intrastate access and intrastate intraLATA toll services. These access and toll services generate revenues which support, through their usage sensitive rates, a significant portion of the cost of local exchange service, and in particular the cost of rural local service.

(c) Additionally, the Missouri PSC took further steps to ensure that rates for residential basic exchange service would be affordable by offsetting an additional portion of these costs⁷. The PSC historically established a rate design for local service which:

- Recovers a proportionally higher share per loop of the local exchange costs from business customers than residence customers. Average basic local rates for business customers are on the average 2.8 times the basic local rate for residence customers, (even though the cost is essentially the same).
- Recovers a larger share of basic local exchange costs from rates for discretionary

⁶ Id.

⁷ The Missouri Commission has chosen to set prices for these intrastate services pursuant to the pricing principles enumerated in a 1977 decision in Docket 18309 through pricing non-basic services above costs (typically pursuant to a long run incremental cost analysis) plus contribution to keep the price of basic service low.

non-basic local service custom calling features, such as Call Waiting, Call Forwarding, etc.

In summary, if basic residential rates had been established at their actual cost levels on a deaveraged basis, local customers in rural areas would have paid approximately \$121.26 per line per month and those in high-volume areas would have paid approximately \$32.10 per line per month. On a statewide average basis, the rate would have been approximately \$39.95 per line per month. Instead, because of the revenue cost support generated by the Part 36 actual cost reassignments to other services and Missouri rate design actual cost support, the PSC was able to establish an average local exchange residential rate in Missouri for SWBT customers of approximately \$10.41 per month.

7. ACTUAL BOOK COSTS HAVE BEEN USED AS THE BASIS FOR SETTING AGGREGATE RATES IN MISSOURI. The traditional cost standard for Missouri which has historically been used to (a) determine total costs of facilities used to provide service; (b) determine the respective interstate (FCC) versus intrastate (Missouri PSC) cost responsibility for recovery in rates and which is the basis for those rates; and (c) establish support from toll and access rates to enable the maintenance of reasonably priced local exchange rates, is the actual book costs as defined by FCC Part 32 and Part 36 actual book cost procedures. These book costs have been used by the FCC and the Missouri PSC as the only valid standard for use in establishing overall interstate and intrastate cost recovery levels because they reflect the actual cost of loops, local switches and transport facilities used to provide service. These are the costs which SWBT has funded through the use of stockholder equity and debt, and are the costs which would be used to value company assets if they were to be sold. The Missouri PSC has utilized these costs in former

rate case proceedings to establish an intrastate revenue requirement for SWBT. Similarly, the FCC requires that these costs be used to report the interstate costs for which the FCC is responsible via the Automated Reporting Management Information System (ARMIS).

8. THE COST STANDARDS USED BY THE PSC IN ITS ARBITRATION AWARD DO NOT ALLOW RECOVERY OF ACTUAL BOOK COSTS. In its Final Arbitration Order, the Missouri PSC arbitrarily created hypothetical costs for loop, local switching and transport facilities and ignored the actual costs of these facilities. A comparison of current revenues which recover the Missouri statewide actual costs for SWBT in each of the operating categories (loop, local switching and transport) with the hypothetical costs as prescribed by the Missouri PSC in its Final Order establishing prices for UNEs in this proceeding,⁸ demonstrates that the level of the hypothetical costs is well below SWBT's current revenues which recover actual costs. Even if hypothetical costs (such as forward-looking economic costs) were to be used, they should be compared with and validated against the historical book costs which actually provide network facilities for SWBT's customers. This "sanity check" would ensure that the hypothetical costs are in fact sufficient (as required by the Federal Telecommunications Act of 1996) to provide a network and service to customers. The comparison presented by SWBT, of current revenues which recover actual costs and of actual costs to the Commission's hypothetical costs, shows that the Commission's costs are not sufficient to provide network service and are in fact deficient. Among the many reasons for the deficiency of these hypothetical costs are that they do not include or reflect the costs incurred to provide sufficient facilities or investment levels

⁸ Affidavit of Mr. William C. Bailey dated August 20, 1997 in this proceeding.

required to efficiently serve future customers, nor do they provide for existing SWBT carrier of last resort responsibilities. Specifically, the hypothetical costs are inappropriately lower than actual costs primarily because:

- hypothetical fill factors employed by the Commission in setting UNE prices are substantially higher than actual fill factors.
- hypothetical vendor discounts for switching equipment employed by the Commission in setting UNE prices reduce investment amounts substantially below actual achieved levels.
- the forward-looking studies hypothetically assume the use of 100 percent SONET architecture and fiber facilities for all transport routes. This causes a greater hypothetical efficiency and lower costs per unit of capacity than achieved by the existing network.
- forward-looking studies by understating investment, result in lower estimates of facility investment related expenses, e.g., maintenance, depreciation, property taxes, etc.

Finally, sufficient forward-looking or economic depreciation is not included in the Commissions' hypothetical costs, as detailed in the affidavit of Mr. John Lube, filed on behalf of SWBT. The Table set forth below compares SWBT's actual Missouri book costs with the hypothetical costs for UNEs adopted by the Missouri PUC.